

ALIGNMENT OF PERSONAL ETHICS, ORGANIZATIONAL CULTURE, CORPORATE PERFORMANCE AND RISK MANAGEMENT TO CORPORATE SUCCESS: THE CASE OF THE GLOBAL FINANCIAL MANAGEMENT INDUSTRY

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Abstract

The global financial crisis has exposed significant flaws in personal and organizational management standards and practices. A model is proposed which postulates that when personal ethics, organizational culture and ethics, corporate performance and risk management are aligned in accordance with the hierarchy suggested by the book “Path of the Just”, written in seventeenth century by the Jewish Rabbi Moshe Chaim Lutzato, the individual worker is better able to align individual objectives with the firm’s, and while so doing improves productivity and efficiency both of himself (or herself) and the firm’s. The new ethics-based method, may lead individuals – in the financial markets - to an exceptional self-improvement level and, ultimately, personal and organizational excellence. The paper provides a survey of the relevant theories, the essential hypotheses of the model and a proposed methodology for validation using Structural Equations Modeling (SEM). Data for the analysis are collected via case studies and questionnaires in various industries and corporations.

Key words: Financial crisis, personal ethics, organizational culture, corporate performance

An Overview

Empirically based literature on individual decision and choice has acknowledged that human agents violate many of the fundamental assumptions of economic theory (Camerer 1999). Sometimes, this type of behavior, whether acting as individuals or under the auspices of an organization, appears to have fallen well short of what would generally be regarded as professional conduct, through cases of willful negligence or even financial frauds.

The collapse of Barings Bank is associated with the name of a single employee, Nicholas Leeson. In 1992, Leeson was appointed head of settlement in Barings Singapore where his outstanding success led his additional appointment as head of trading. A major cause of the bank's collapse seems to have been the lack of accountability and excessive risk taking on the part of its young derivatives trader, Leeson,

The collapse of Bank Le Mischar in Israel is also associated with the name of a single employee – Eti Alon. Since September 2001 and until end of April 2002, Eti Alon whom was deputy of trading had embezzled the amount of 250 million NIS, causing the bank's collapse. The embezzlement hadn't been detected by the bank's internal auditing and control or by the bank management or its board of directors.

Andrew Stuart Fastow of Enron, Bernard Madoff, Brian Hunter from Amaranth Advisors, Yasuo Hamanaka from Sumitomo and John Rusnak from Allied Irish Bank – all are individuals which their un-ethical behavior caused a sever damage to their customers and organizations.

In his perspective article "Why ethics codes don't work", soon after the 2003 market downfall, Dobson (2003) stated: "Ethical guidelines and codes of conduct have never been more widespread in the financial services industry", continuing by asking "So why have some individuals ignored even the most basic precept of these guidelines?"

Three joint elements, influencing one another, seem to have caused those downfalls: (1) Poor Corporate Management – or management without any method - which left excessive concentration of power in the hands of the individual. (2) Corporate Culture which allowed the implied moral education to come only through exposure to the values displayed by the surrounding and from observing the actual behavior of other individuals. (3) Professional ethics and personal behavior which had fallen well short of what would generally be regarded as professional conduct, through cases of willful negligence and financial fraud.

Research Objectives

The above described situations are well known and, unfortunately, seem to be widespread. The common solutions to eliminate such downfalls and losses seem to be adding more organization control - ethical codes and codes of conducts, tightened auditing, internal investigations etc' - which could result in alienation, trustworthiness weakening and reliability wearing between the organization and its individuals.

This research hypothesizes that when personal ethics, organizational culture and management, corporate performance and risk management align, the individual worker is better able to align individual objectives with the firm's, thus improving both himself (or herself) as well as the firm's productivity and efficiency.

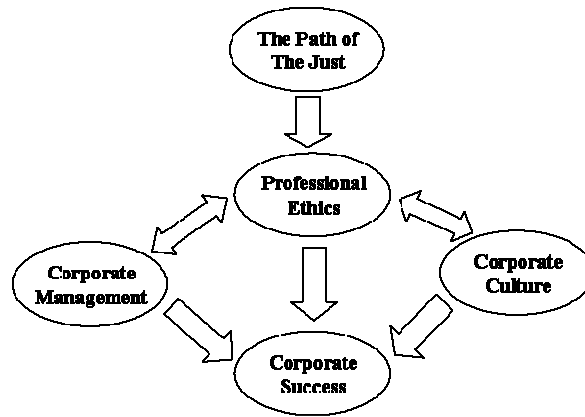


Fig. 1 The model

A new, individual-leaning, ethics-based paradigm that can be measured and quantified is offered. The paradigm is based on the seventeenth century book "The Path of the Just", by Rabbi Moshe Chaim Lutzato, and may lead individuals, engaged by organizations in the financial markets, to an exceptional self-improvement level and ultimately beyond excellence. The paradigm is based on a five-part model, which has certain dependencies between the individual parts.

Corporate Culture, Corporate Management and Leaders

As oppose to the downfalls and collapses of corporate organs described earlier, there are success stories which combine personal behavior with Corporate Culture and Management as well, but result in organizational excellence.

In 1986, Bill Smith, a senior engineer and scientist within Motorola's Communications Division, introduced the concept of Six Sigma. He took his ideas to CEO Bob Galvin, who was struck by Smith's passion and came to recognize the approach as key to addressing quality concerns. As a result, in 1988 Motorola became the first company to win the Malcolm Baldrige National Quality Award. In 1990, Motorola—together with companies such as IBM, Texas Instruments and Xerox—created the concept of Black Belts. As a Motorola employee, Smith did not share directly in the profits generated by the company's Six Sigma applications. However, over the years, he and Motorola garnered numerous awards and recognition for his vital work to improve profitability in America's manufacturing sector.

In his "Businessweek" column from November 2006 titled "Send the Jerks Packing" - Jack Welch, the legendary former CEO of GE calls to weed out the "bad apples" from the organization. The "Jerks", according to Welch, are the ones who deliver the numbers but don't live the values; these high performers can be mean, secretive, or arrogant. Very often they kiss up and kick down. Some are stone-cold loners, while others are moody, keeping those

around them in a kind of terrorized thrall. Welch himself was known for his brutal candor in his meetings with executives. He would push his managers to perform, but he would reward those in the top 20% with bonuses and stock options. Welch adopted Motorola's Six Sigma quality program in late 1995 and when he left GE, the company had gone from a market value of \$14 billion to one of more than \$410 billion at the end of 2004, making it the most valuable and largest company in the world. Other names, with similar success stories, can be mentioned – Deming, Buffett, Gates and more.

Three elements had led those individual leaders and their organizations to excellence: (1) Corporate Management - quality based management, leading the organization and its individuals to a continuous improvement process to excellence. (2) Corporate Culture which allowed the implied moral education to come through personal example. (3) Professional ethics based on professional practice and ethical behavior based on social values.

Professional Ethics and the Financial Industry

In financial economic theory, rational agents are rational opportunists and their ideal behavior is material opportunism (Von Neumann and Morgenstern 1947). Dobson (2003) summarizes the problem by saying that if the narrow notion of self-interest is the only rational way to behave, then to hold some principle other than material opportunism – such as honesty and integrity - is simply irrational and wrong.

Professional ethics, says Kasher (2005) within the framework of that practice, is a conception of that practice. Therefore, values and norms, principles and rules, policies and problems solutions of professional ethics all stem from that basic conception. Professional ethics should consist the following three parts: (a) Professional practice - involves knowledge and proficiency, improvement and understanding. (b) The specific vocation of a certain profession – basically should answer the question: "what exactly is it to be this profession (e.g. a physician, an engineer)?" or "what is it for this professional to practice his or hers profession?" (c) Compatibility of the professional practice under consideration with the basic values of its societal envelope, particularly by principle of democracy: human dignity, justice and fairness.

This third part seems to be lacking in the financial industries. Therefore, a new method should be applied where aligning individual objectives with the organization's, based on ethical values, could lead the organization to excellence.

The Path of the Just

The “Path of the Just” which was written in the seventeenth century by the Jewish Rabbi Luzato Chaim aims its words to remind and explain to each individual one’s personal obligations towards oneself, his surrounding and environment but mainly towards his personal moral beliefs. The book was written as a commentary to a famous citation from the Talmud (Avoda Zara, 20b) and can be transformed, as follows, to a managerial language and then turn to a SADT model which will expose its basic components in a schematic model (Dickover, McGoan, & Ross 1977): *”Learning leads to Vigilance; Vigilance leads to Zeal; Zeal leads to Integrity; Integrity leads to Innovativeness; Innovativeness leads to Clear-sightedness; Clear-sightedness leads to Resourcefulness; Resourcefulness leads to Unpretentiousness; Unpretentiousness leads to Personal Will; Personal Will leads to Inviolability; Inviolability leads to Inspiration, and Inspiration leads to Paradigm Changing”*. The schematic commentary of the book facilitates the reader to learn and comprehend the suggested method which would ultimately lead him to the highest possible level by method of self improvement, reflecting Kasher's definition of Professional Ethics – professional practice, its specific vocation and its societal envelope.

The model has three major blocks where each block contains several levels. Vigilance and Zeal, for example, the first two levels, are schematically similar and complementary, where Vigilance, the passive approach, completes Zeal, the active approach. Integrity, probably the longest dimension to achieve, closes the model’s first maturity level. The first maturity level suggests sets of tools and a behavior format, detailed enough to allow the individual to become, or to be considered, a key individual worker. The fourth dimension – Innovativeness – is the first dimension of the second maturity level which suggests a new set of tools, behavioral and quantitative, to become a champion individual worker. The model then keeps developing by suggesting tools to the individual to become a Paradigm Changer.

Research Phases

The research methodology would address issues of *triangulation* (Scandura and Ethlyn 2000) and *validity*. *Triangulation* is a way to improve the ability to draw conclusion from the study by using a variety of methods that result in more robust and generalizable findings.

In addition to the literature review and the case studies, a questionnaire will be distributed among workers (novice, mid-management and top management) from various types of industries, financials and others. The questionnaire will mostly be formed by closed-ended, some scaled and some yes/no, questions. Applying SEM (Structural Equation Modeling), a

confirmatory factor analysis model, will determine whether the model is valid. This will support its construct validity. Its AMOS application will be used. This will support the theory's statistical conclusion validity.

Research significance

The expected contribution of this proposal is significant especially these days when, on the one hand, financial markets are fiercely competitive and demand top performance and, on the other hand, unethical behavior instances by individuals are contributing to financial calamities on a global scale. The unique research approach, suggesting aligning personal ethics, organizational culture and corporate performance may result in a management model where the individual worker is guided through an exceptional self-improvement level, and thus improves corporate performance.

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